

Economic Update

LMID Advisory Group Meeting

March 18, 2004

I. U.S. Economy

February 2004 marked the 27th month of the official U.S. economic recovery. By most measures the U.S. economy continues to gather strength – Gross Domestic product grew at a blistering pace of over 6 percent over the last half of 2003, firms are flush with profits, business investment is increasing, consumer spending is holding steady, international trade is improving (particularly with Asia), and output of goods and services is expanding. Most of the economic tea leaves signal healthy growth ahead.

However, recovery in the labor market continues to lag that of the overall economy, and job growth remains weak. Although most economists anticipate increased hiring as the expansion continues, they are perplexed by the meager job growth of the expansion thus far. Some warn that if hiring does not pick up substantially in coming months, there is a risk that consumers, the bedrock of the U.S. economy, may cut back on spending and threaten the recovery.

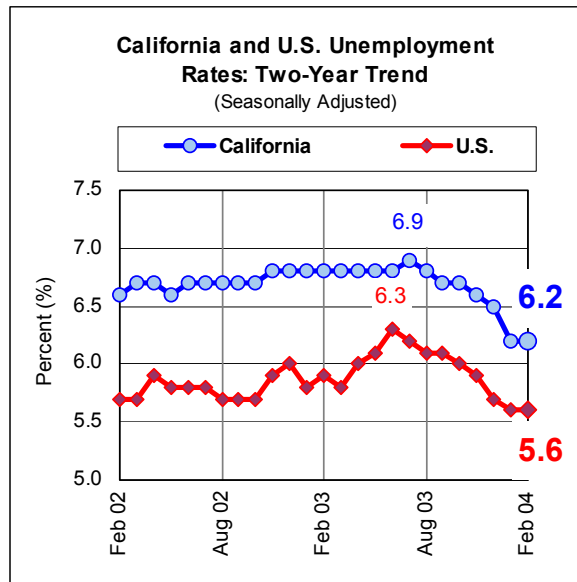
Against this backdrop, this presentation will discuss recent developments in California's labor markets.

II. California Labor Force

Labor Force Employment

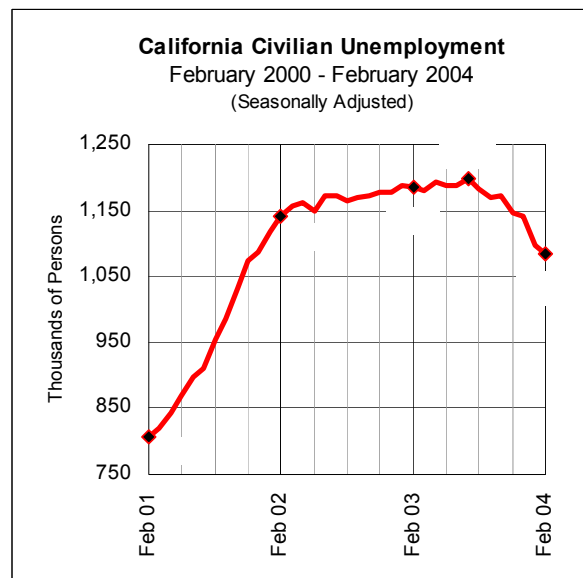
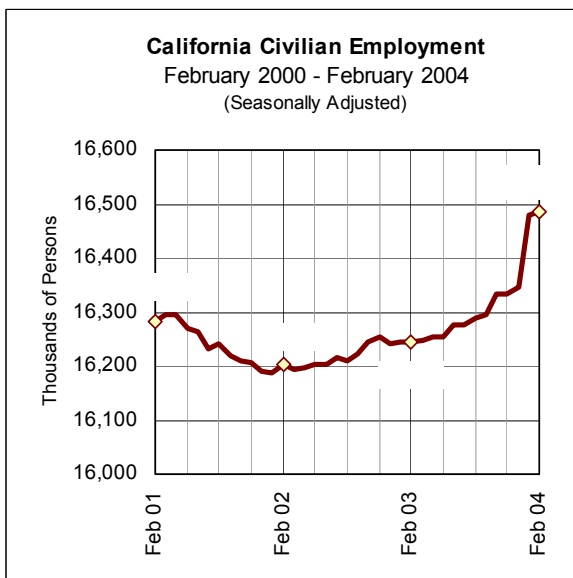
The seasonally adjusted California unemployment rate in February was 6.2 percent, unchanged from January, and down 0.6 percentage point from one year ago. As seen in the chart below, the California rate has been declining in recent months, falling 0.7 percentage point from its recent peak of 6.9 percent in July 2003.

The California rate is largely following national trend. The U.S. unemployment rate was 5.6 percent in February, also unchanged from January, and down 0.3 percentage points from one year ago. The U.S. rate has also declined in recent months, falling 0.7 percentage point from its recent peak of 6.3 percent in June 2003.



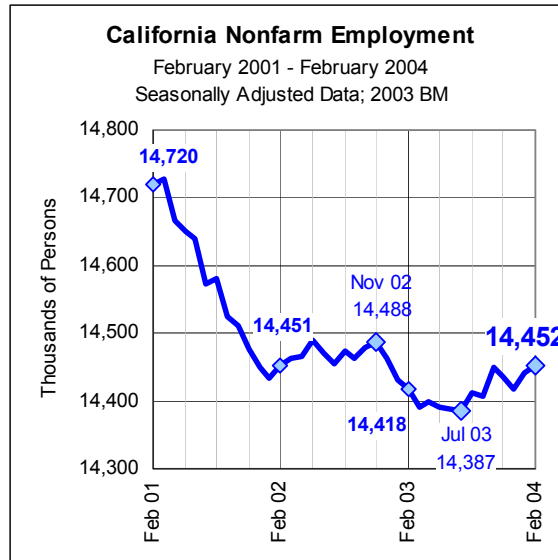
Recent employment and unemployment trends are shown in the chart below. The number of employed Californians rose by 7,000 persons in February to just under 16.5 million. Year-over, California employment has risen by 243,000 persons, or 1.5 percent. However, an exceptionally large 133,000-person gain in January accounts for over half of this gain in employment. If one nets out the January gain, employment has been growing at an annual of about 0.7 percent. In contrast, year-over growth in employment averaged 2.8 percent over the five years leading up to March 2001 recession.

Unemployment continued its recent decline over recent months, falling by 14,000 persons in February to 1,083,000 persons. The number of unemployed Californians has fallen by 114,000 persons since July 2003.

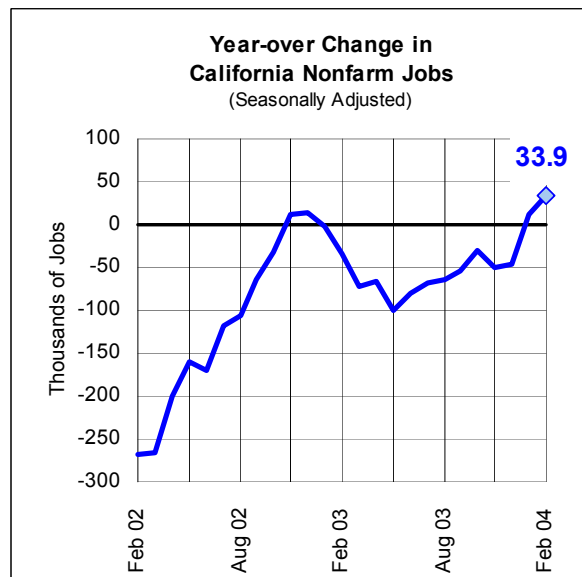
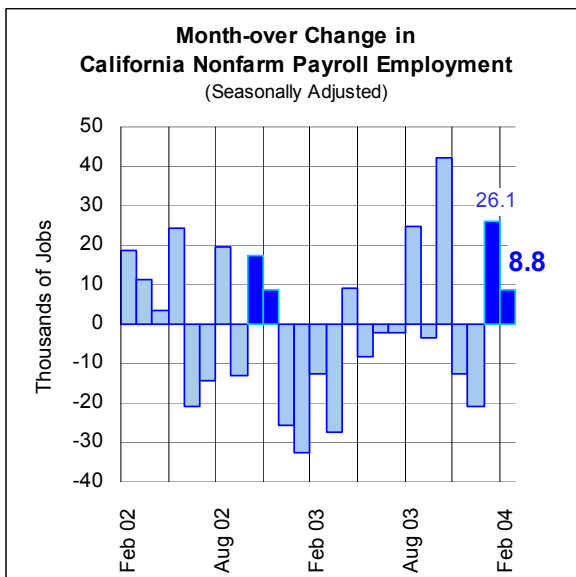


III. Nonfarm Employment

The chart below shows the trend in California's nonfarm employment (number of jobs) over the last three years. The data show a distinct, if somewhat tentative, improvement in job growth in recent months. The economy added 65,000 jobs between August 2003 and February 2004. In contrast, the economy lost 101,000 jobs between November 2002 and July 2003.



California nonfarm payrolls grew by 8,800 jobs (0.1 percent) in February, following a gain of 26,100 jobs in January. As seen in the chart below, this was first back-to-back increase in nonfarm payrolls since October – November 2002. Over the last year, nonfarm payrolls have risen by 33,900 jobs (0.2 percent).



DRAFT

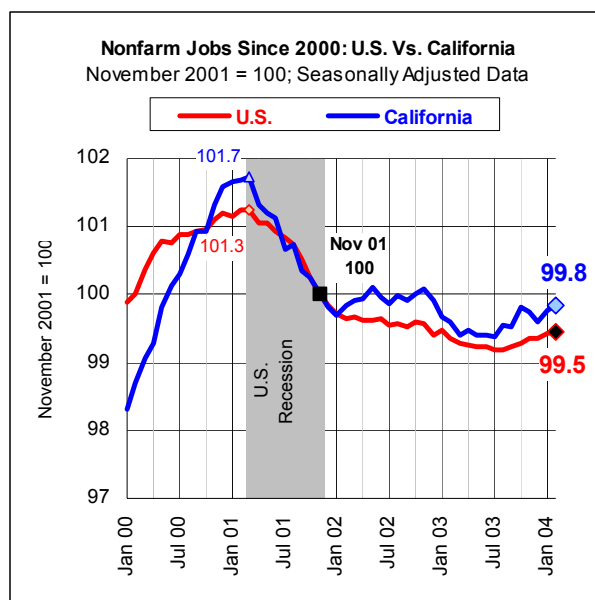
Government has been California's weakest sector over the last year, muting overall job growth. Private sector employment, which excludes government jobs, has been grown by 86,900 jobs (0.7 percent) over the last year, and by 105,700 jobs (0.9 percent) since July 2003.

The U.S. jobs numbers were anemic in February, as nonfarm payrolls increased by just 21,000 jobs (a zero percent change). In addition, December and January job growth numbers were revised down slightly. Government (up 21,000 jobs) accounted for all of the February gain, indicating that private employment was unchanged. In comparison, California added 14,200 jobs in the nonfarm private sector in February.

Year-over, U.S. nonfarm payrolls rose by 122,000 jobs, or 0.1 percent. This compares to California's 0.2 percent year-over gain.

California's job growth has largely paralleled national job growth over recent months. U.S. nonfarm payrolls have risen by 364,000 jobs, or 0.3 percent, since August 2003. In contrast, California nonfarm payrolls have grown by 0.4 percent since July 2003.

Although California has seen a net decline in nonfarm payrolls since the U.S. expansion began in November 2001, the nation has seen even deeper job losses. Whereas California experienced a 0.2 percent decline in nonfarm employment from November 2001 through February 2004, the nation experienced a 0.5 percent decline.



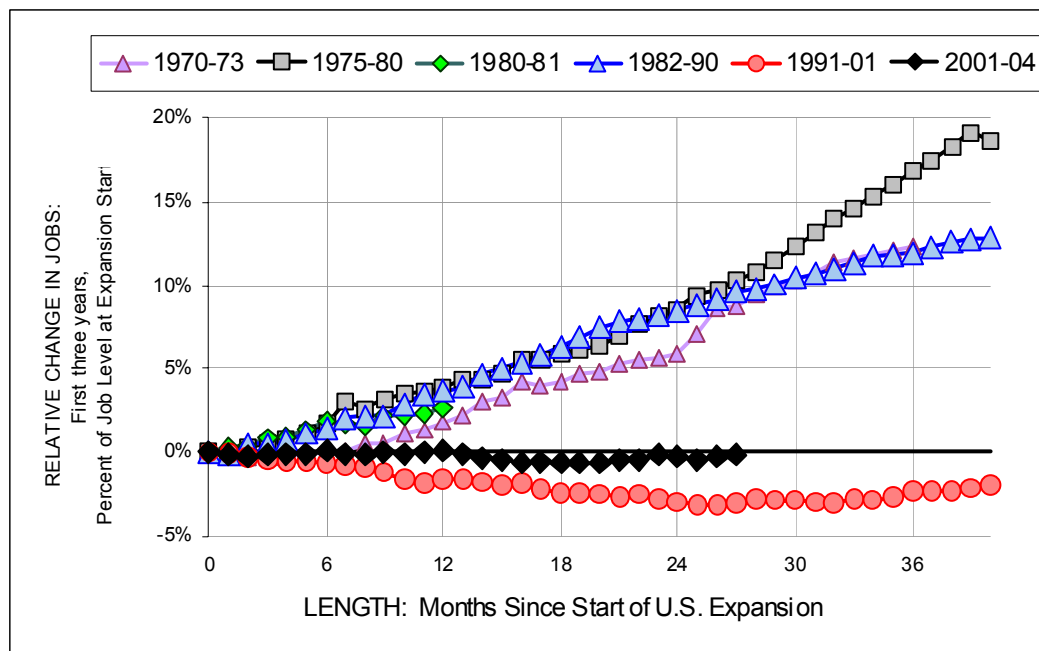
As seen in the chart below, the current expansion has had the weakest job growth of every post-1970 economic expansion except the 1991-2001 expansion, when California was recovering from a recession that was much

DRAFT

deeper than in the U.S. Job growth in the current expansion is lagging that of most expansions in both the U.S. and California.

California Job Gains During Post-1970 Expansions

(Nonfarm Payroll Employment, Seasonally Adjusted)



Several related factors explain the tepid job growth of the current recovery, including:

- **Rising productivity.** Instead of hiring new workers, firms have been able to meet demand by getting more out of existing workers and facilities. Productivity grew at a very rapid pace in 2002 and 2003. Although the pace of productivity growth has slowed and this should produce more hiring, it remains unclear where productivity gains will settle. The stronger are productivity gains, the fewer the number of workers that will need to be hired. It also appears that many firms are investing in productivity enhancing equipment, including computer and information technologies, in lieu of hiring.
- **Cost and price pressures, or the “Wal-Martization” of business.** Large customers are demanding low prices from suppliers, creating intense pressure on firms to cut costs and keep prices low.
- **Offshoring.** Although not a cause of job losses during the downturn per se, many companies are expanding operations and hiring in countries such as India and China where labor costs are much, much lower instead of hiring locally. This is particularly true for the high technology and information technology sector, and services that can be provided via

DRAFT

communication links. The overall effect of offshoring has likely been quite limited to date.

- **Rising Labor Costs.** Although wages are growing slowly, rising health care and benefit costs are pushing total employee compensation costs ever higher. This creates additional disincentives to hire in today's cost conscious environment. Many companies are hiring temporary and contract workers, who typically command lower wages and minimal benefits, instead of full-time workers in order to minimize costs.

Nationally, employment services has grown by 225,000 jobs over the last year, while total nonfarm employment has grown by only 122,000 jobs. (seasonally adjusted data). In California, employment services has grown by 52,100 jobs (or 13 percent) over the last year, accounting for over 85 percent of California's net year-over employment gains (not seasonally adjusted data).

Although some observers speculate that reliance on temporary and contract work may represent a new business model, one would expect temporary and contingent work arrangements hiring eventually to yield to full-time employment in a strong and sustained economic recovery.

- **Psychology.** Given the false starts and shocks to the economy over the last three years, many employers remain leery about the sustainability of the current economy recovery.

IV. Industry Trends

Year-over growth trends in California's major industry sectors are shown in the chart below.

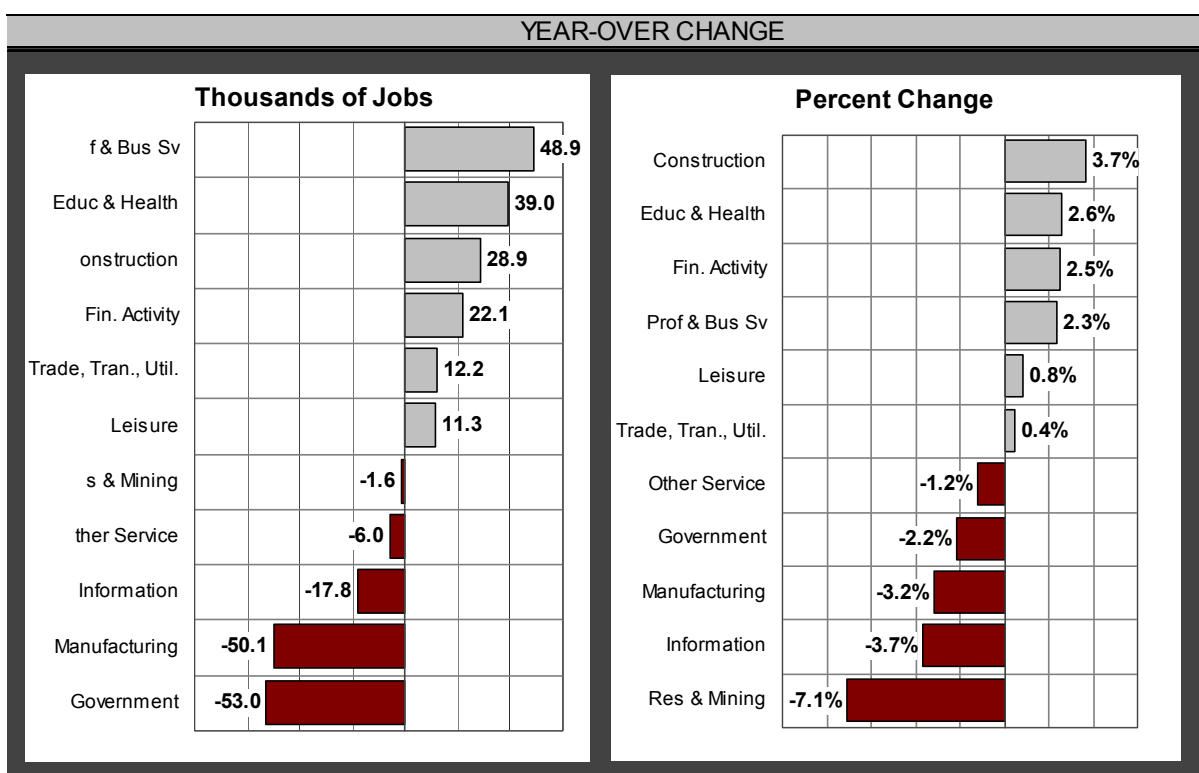
Six of California's eleven major sectors showed year-over gains in February, while five lost jobs.

Job growth has been strongest in professional and business services, which has been boosted by the surge in employment services, as well as California's population-serving sectors – private educational and health services, construction, financial activities, as well as industries such as food and drinking places and retail trade.

Four sectors – professional and business services, educational and health services, construction, and financial activities -- added 138,900 jobs over the last year. However, these gains were muted by losses totaling 103,100 jobs in government and manufacturing.

Year-over Job Change in California Industry Sectors: February 2004

Seasonally Adjusted Data



Highlighting developments in a few sectors:

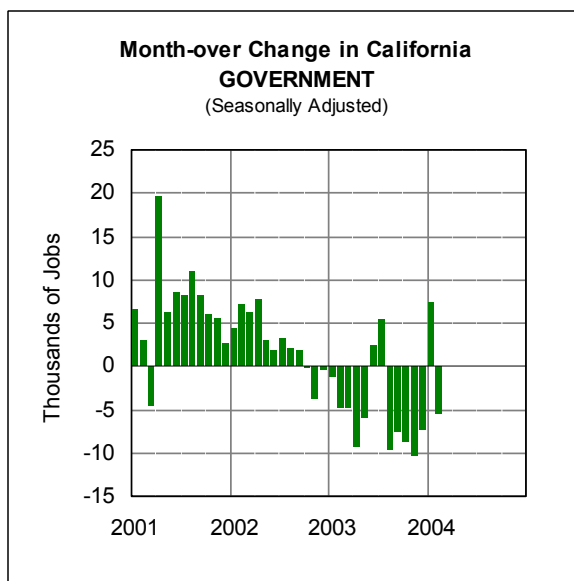
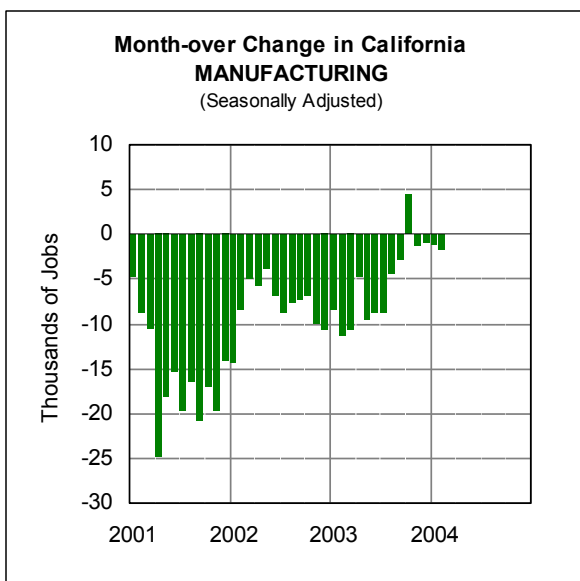
The bleeding seems to be ending in the information sector. Although year-over losses total 17,800 jobs (or 3.7 percent), information has added jobs in four of the last five months, with gains totaling 7,500 jobs. In contrast, job losses totaled 25,300 jobs over the previous seven months.

Year-over manufacturing job losses totaled 50,100 jobs (or 3.2 percent). Manufacturing has lost jobs in 36 of the last 37 months, with losses totaling 354,700 jobs. However, as seen in the chart below, the pace of job manufacturing job losses has slowed markedly in recent months. Losses over the last six months totaled just 3,300 jobs, compared to losses totaling 46,800 jobs over the previous six months.

Government continues to be California's weakest sector, losing 5,400 jobs in February. Despite a 7,400-job gain in January, net government losses over the last seven months total 41,000 jobs, and year-over job losses total 53,000 jobs (or 2.2 percent).

DRAFT

Unadjusted data continue to show that these year-over job losses were concentrated in local government, which accounted for 82 percent of total government losses. Local government education alone accounted for two-thirds of government losses.



V. California Area Trends

Following are the five California areas that gained and lost the most jobs over the last year. The data continue to show that the strongest job growth occurred in Southern California and Central Valley metropolitan areas. The Bay Area continues to suffer the steepest job losses.

Gaining Areas

- | | |
|--------------------------------|----------------------------|
| • Riverside-San Bernardino MSA | +22,200 jobs (2.1 percent) |
| • Orange County MSA | +14,200 jobs (1.0 percent) |
| • San Diego MSA | +10,500 jobs (0.9 percent) |
| • Sacramento MSA | + 6,000 jobs (0.8 percent) |
| • Fresno MSA | + 3,500 jobs (1.1 percent) |

Losing Areas

- | | |
|------------------------------|----------------------------|
| • San Jose MSA | -21,300 jobs (2.5 percent) |
| • San Francisco MSA | -18,500 jobs (1.9 percent) |
| • Oakland MSA | -15,700 jobs (1.5 percent) |
| • Santa Rosa MSA | - 3,600 jobs (2.0 percent) |
| • Los Angeles-Long Beach MSA | - 3,000 jobs (0.1 percent) |